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TAGS: DR ENRG ECON EINV EFIN
SUBJECT: DOMINICAN GOVERNMENT SAYS IT WANTS TO RENEGOTIATE ENGERY CONTRACTS

¶1. (U) In late April the Dominican Commission for the Renegotiation of Contracts in the Electric Sector publicized its formal decision to seek renegotiation of contracts signed by the government and electricity generators, alleging that technical flaws in the formulas are resulting in excessive payments. The Commission questions the Madrid Agreement of 2002 between the government and generators, never implemented, which set revised rates to be implemented in exchange for World-Bank-financed payments of USD 150 million. The Commission is approaching individual generators, none of whom accept its rationale. While some of the Commission hardliners probably believe in the "force majeure" argument -- that the government is not obliged to comply with impossible terms -- this undertaking was probably aimed in the short term at winning votes in the May 16 congressional elections.

The Renegotiation Document

¶2. (U) Shortly after its April 18 publication in newspapers of a press statement, the Commission sent a 16-page strategy document to all generation companies. The text asserts that the formulas used in the generation contracts and in the Madrid Agreement of 2002 are faulty, in part because they used inappropriate reference prices and in greater part because the agreed tariffs are not based on an arithmetic formula including fuel costs (adjustable to market conditions), return on capital (referring to initial investment) and operating expenses (relating to actual costs). The analysis says that the Madrid Agreement is flawed because the calculated values are based on the average costs of generation of the sector as a whole. The document cites the fact that the generators Haina and Itabo, facing the defined values, brought on-line their least-cost generation units and then chose to buy from the spot market to meet their production requirements. The Commission asserts that this management decision undercuts the basis of the agreement and renders it invalid. The document also declares that Cogentrix needs to reduce its prices by 15-20 percent and Smith-Enron by 30-40 percent.

¶3. (U) The Commission for Renegotiation forecasts that the government will save between USD 423 and USD 507 million a year once the contracts are renegotiated to its standards. The document asserts that after this renegotiation the government will be able to remove subsidies and the consumer will spend less for better quality.

The Response from the Generators

¶4. (SBU) Smith- Enron representative Otto Gonzalez told EconOff that he believes this desire to change the contract is "mainly a political tactic" to show the public that the government is working on the energy sector problems. Gonzalez said, "It is difficult to see what possible gain generators would have in renegotiating their contracts." Gonzalez defended Smith-Enron's own deal, emphasizing that it is a financial contract. His investors accepted a payment scheme based on "take or pay" provisions for installed capacity rather than for consumption. The Dominican government subsequently changed its own strategy. Now the government purchases energy in a hierarchy with the cheapest sources of energy consumed first. In this equation, more expensive energy is never brought. Gonzalez asked, "Why would someone with a contract based on installed capacity switch to a payment for consumption contract, especially if coal-fired generation comes into play?"

¶5. (SBU) Roberto Herrera, Deputy General Manager of La Compania de Electricidad de San Pedro de Macoris told EconOff that he was sure his lenders would not be willing to renegotiate.

¶6. (SBU) Herrera stated, "This is not the first time the government has tried to renegotiate the deal and unfortunately will not be the last time." Herrera administers a contract that is good until 2021 and unless his lenders get a better offer, Herrera states, "There's no deal."

¶7. (SBU) When asked if his company would renegotiate, Marcos Cochon, General Manager of Compania de Electricidad de Puerto Plata (formally of the El Paso Corporation) told the Dominican authorities he was unsure and first he would have to know the terms of the renegotiation.

The Carrot and the Stick

¶8. (U) The Dominican government has not offered the outlines of any approach to renegotiation. It is rumored that the government will offer to pay all old debt in return for renegotiating the contracts. The repayment may be in bonds or cash.

¶9. (SBU) Negotiating the contracts in return for receiving repayment for past debt may work for some companies. In fact, the Smith-Enron representative told EconOff that since the government owes the company a large sum of money the lenders might be persuaded to accept renegotiation of their contract for payment of all their old debt. Other companies such as Haina are owed debt from the distributor EdeEste, which is 50 percent owned by Trust Company West (TCW), an American company. Therefore, it may not benefit Haina to exchange payment of debt from the Dominican government for lower generating prices, especially if EdeEste does not agree to the government's plan.

¶10. (U) For the "stick" the government has several options. In its April press message, the Commission stated that the generators are receiving an unfair benefit that is negatively affecting the Dominican people. This type of media pressure could increase and may rise to the level of personal media attacks. Dominican authorities, theoretically, could take this matter to arbitration.

Renegotiation Could Trigger Bankruptcy

¶11. (SBU) If the government does decide to use repayment of old debt as a bargaining chip to encourage renegotiation of energy contracts, this could prove difficult for EdeEste. Generation companies that work with EdeSur and EdeNorte would receive payment from all of their old debt and generation companies that work with EdeEste may demand the same. EdeEste is in debt to several generators; they owe Haina USD

50 million, Itabo USD 50 million, and AES Andres USD 80 million. The total cross-sector debt is more than USD 400 million.

¶12. (SBU) Haina has been threatening to sue EdeEste for their USD 50 million. The renegotiation agreement could give Haina the power necessary to demand their owed debt from EdeEste. According to EdeEste, if Haina sues EdeEste, Itabo and AES Andres will also demand their money. This chain reaction of lawsuits, will force EdeEste into bankruptcy. Dominican law dictates that EdeEste, once bankrupt, will have to have new managers. EdeEste managers have long felt that the Dominican government has been interested in expropriating EdeEste.

¶13. (SBU) Corrigan said they will not stay where they are not wanted and in a "worst case scenario" AES would be willing to sell their managerial control. Their contract with TCW allows them to manage for 10 years and they are paid 2.5 percent of the revenue. AES would need at least USD 45 million to reach a settlement.

¶14. (U) Several senior executives of EdeEste and TCW will meet with the Deputy Chief of Mission, Econ, and USAID on May 24 to discuss the issue.

Think Tank Disagrees

¶15. (U) The government hired London economic think tank Adam Smith Institute (ASI) to do an independent study of the energy sector. ASI stated that talk of renegotiation is indicative of the way the Dominican market is moving to a single buyer model. ASI also warned, "Unilateral breaking of contracts by distributors or CDEEE would be seen as increasing country and sector risk, offsetting gains from lower prices." ASI thought the more urgent matter was corruption: ASI states there is political support for those stealing electricity and that the energy sector is used for political patronage. ASI states there must be a consistent message in a concerted campaign about how theft is the primary cause of the problems in the sector. Just normal press coverage will not be enough.

¶16. (SBU) President Fernandez received the ASI representatives in a closed meeting. According to one of the participants, ASI representatives told Fernandez that he must act on corruption in the sector. Energy contacts state that

the largest Dominican grocery chain, Supermercado Nacional, was recently found to have not paid significant percentages of its electric bill and representatives from the National Program to Eliminate Electric Fraud (PAEF) approached them. After a few phone calls by the supermarket executives, the matter was "cleared up." The ASI representatives also told Fernandez about this situation in their closed meeting.

¶17. (U) Additionally, in their report ASI warns against any "unilateral breaking of contracts" by the distributors or the Dominican government because this action would increase country and sector risk and offset any gains for lower prices.

Looming on the Horizon

¶18. (U) If the government pressures the generators to renegotiate the contracts this is likely to have a direct negative effect on the business climate, just as the country is moving toward implementing the CAFTA-DR free trade agreement. But more to the point, a renegotiation under duress would do little to solve the energy problem. That would require the government to remove politics from energy by aggressively campaigning and fining entities that abuse the system.

¶19. Drafted by Jehan Jones.

HERTELL